

IMPROVING THE DISCLOSURE OF FINANCIAL INFORMATION IN LOCAL GOVERNMENTS

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ABSTRACT

In the public sector, as well as in the private sector, the objectives of financial reporting are determined by the needs of its users, which are typically summarized in two categories: (1) a means to effectively control the manner in which resources are administered and legal obligations are accomplished, and (2) a supporting tool for decision making. Thus, terms such as "accountability" and "decision making" are usually employed to frame the basic objectives of accounting reporting (IFAC, 1991, par. 62). Different types of users deem the relative importance of each objective differently. However, in the public sector, it is widely accepted that users are more interested in the accountability purpose. Therefore, governments should orient their reports to subordinate the "utility focus" and emphasize the "accountability focus."

INTRODUCTION

Public accountability roots on the belief that citizens have the "right to know", in other words, the right to be provided with reliable data that makes possible the debate between citizens and elected representatives. Financial reporting plays a fundamental role in the accomplishment of the accountability duty in a democratic society (GASB, 1987). Accounting information systems, in order to allow evaluating the different levels of public accountability, require that financial statements include plenty of information on issues such as the budgetary execution level, liquidity and solvency, indebtedness level, cost of the services and goals achieved.

However, rather than just limit to elaborate financial reports, local governments should be able to grant effective access to the citizenship. It is true that, adopting a strict accountability view, accounting systems are beneficial even in the case that none of the two parties involved does ever consult the reports generated (Ijiri, 1983: 78). But there is no question that such benefits are enormously increased when the system creates the conditions for an effective exchange of information between the two parties. For this reason, there is a growing interest today on "financial disclosure", which parallels the emphasis of private organizations on internal and external communication throughout the last two decades.

This article analyzes the role of the annual report in the process of financial disclosure in local governments. The next section reviews the normative guarantees regarding the access to financial information in local entities. Then, in the third and fourth sections, we describe the state of the art of financial disclosure, analysing the main communication tools that are being currently employed (reports and communication channels). The fifth section discusses the differences and commonalities derived from a comparative analysis of how this document is being elaborated and used by local

governments located on different countries across the world. Concluding remarks are provided in a final section.

LEGAL PROVISIONS REGARDING THE ACCESS TO FINANCIAL INFORMATION

In developed countries, the right of the different groups of users to access to financial information is granted by legal accounting provisions. The purpose of these provisions is to guarantee the availability of information, but, in most cases, local governments are not compelled to undertake a proactive disclosure policy. We start the study of current experiences on financial disclosure with a brief survey of the accounting provisions regarding access to public financial reports. These provisions are then contrasted with the more transparent practices adopted by a growing number of local governments.

An overview of the current norms and policies on the access to financial information in the public sector reveals a very heterogeneous picture. According to the *Green Article on Public Sector information in the Information Society*:

Public information in Europe is often fragmented and dispersed and so in many instances it is less clear than intended. This situation is mainly due to differing national legislation on the ways information can be accessed and exploited, and to various practices that hamper the availability of data. The issue at stake is not that Member States should produce more information, but that the information, which is already available to the public, should be clearer and more accessible to potential users (European Commission, 1998: par. 2).

The first legislative initiative of the EU to overcome these deficiencies was the adoption of Directive 90/313/EEC of June 23, 1990, on the freedom of access to information on the environment held by public authorities. Although some efforts have been made in the right direction, a similar provision in the field of public financial reporting does not exist yet. Currently, each Member State follows different approaches to regulate the access to financial information. Limits to the right to access are justified on the basis of preserving the national interest, protecting the decision making process and avoiding unreasonable costs or workload.

The United States is probably the country with easier access to public information. The *Freedom of Information Act* (FOIA), enacted in 1966 and amended in 1996 by the *Electronic Freedom of Information Act* (EFOIA), has contributed it in a decisive way to guarantee public access to federal government information. France laws include specific provisions concerning the access to the reports elaborated by local entities. The 17th article of Act 92-125, of February 6/1992, establishes that "all persons and institutions are entitled to demand information of the records of the municipal council, of the budget and accounts of the municipality, and of the municipal decisions or ordinances".

In Spain, the availability of the information elaborated by the public sector is regulated by the Act 30/1992 of November 26, which recognises the citizens' right to access the Administration's files. This act lacks any explicit reference to public financial reporting, but an analysis of the accounting and budgetary specific requirements shows the following:¹

1. *PUBLIC EXPOSURE PERIOD.* The budget is publicly exposed during the 15 days before final approval. Then, the approved budget is published in the Council's Official Bulletin and in the Official Bulletin of the province or Autonomous Community. In the same manner, the "General Account" (Cuenta General), together with the Special Commission of Accounts report, must be publicly exposed for 15 days, so that those interested can lodge complaints, objections, and observations.
2. *SUBMISSION TO OTHER PUBLIC AUTHORITIES.* Local entities must submit a copy of the implemented budget to the Ministry of the Treasury and to the Autonomous Community before April of the next financial year.
3. *SUBMISSION TO THE TRIBUNAL DE CUENTAS.* Local entities must submit the General Account approved for the former financial year to the Tribunal de Cuentas (National Audit Office), attaching a set of supporting documents.
4. *INFORMATION FOR THE ELECTED REPRESENTATIVES.* The Local Entity's Comptroller must submit to the elected representatives information about the original and modified budget, actual results, and cash, in the terms established by the elected representatives. On the other hand, the budget must be submitted to the elected representatives for approval, amendment or rejection. An advance of the implemented budget for the current financial year must be attached to this budget. The elected representatives must also approve the General Account.
5. *INFORMATION FOR THE MANAGEMENT.* The accounting system must provide all the economic and financial information relevant for managerial decision making.
6. *CENTRAL DE RIESGOS.* The 56th article of the LRHL (amended by the Act 50/1998) established the creation of the Central de Riesgos, an agency dependent from the Ministry of the Treasury that provides information about the credit transactions of local entities and the subsequent financial duties. Banks, saving loans, other financial institution, and public Administrations must submit all the needed information.

As these precepts evidence, access is not equally granted to every group of users of public financial information. For instance, a citizen that wants to consult some information must do it in the entity's physical building during a very specific and short time period. After the deadline the citizen must submit a formal application that is sometimes disregarded. Thus, the access to public information is not completely guaranteed. In this sense, Ijiri (1983) has suggested that, from an accountability perspective, a situation in which the *accountee* can access more information about the *accountor* is not necessarily preferable. Some degree of managerial privacy is always required, and thus an excess of information disclosure may thus damage the local government, and, in turn, society. However, real financial disclosure practices are far

from being able to cause any damage on privacy. On this ground, many governments consider that financial disclosure should be reinforced. The following section analyzes the two fundamental elements in the disclosure process: the reports summarising the information and the communication channels.

THE REPORTS: FROM FINANCIAL STATEMENTS TO ANNUAL REPORTS

Currently, annual financial statements constitute the main tool to demonstrate public accountability. As the GASB (1987) has pointed out, financial statements are not the only source of information, but are "the core of the financial reporting and are the principal means of communicating financial information to external users."

Traditional financial statements reveal a low concern with information disclosure. In continental Europe, local government accountability has been limited to budgetary issues, subordinating information on assets, financial structure, and economic results to a secondary place. Traditionally, the accounts in these countries have been almost exclusively oriented to satisfy audit offices, resulting in extremely large reports of scant utility for the other groups of users. The most recent accounting reforms show a marked interest in adapting the structure and content of financial statements to the needs of the users and, at the same time, in impelling the elaboration of new reports, as a means to foster communication among the parties.

Contents Enhancement of Traditional Financial Statements

The multiple proposals recently directed to enhance the content of financial statements had a twofold objective. On the one hand, it is considered a necessity to include new information in these reports to help fulfil government's duty to be accountable at various levels (from legal accountability to managerial accountability). On the other hand, it is deemed appropriate to include textual explanations that may contribute to a better understanding of the reports, embracing a new conception of accountability that involves not only "inform of" but also "explain" the transactions' nature and their reasons (Ives, 1987). The proposals imply the following:

1. *To incorporate data useful to analyze the environment and the financial condition of the local entity, as a means to transform financial reports into a tool for the estimation of "financial well-being", in order to demonstrate political accountability (GASB, 1987; CICA, 1990, 1993; IFAC, 1991).*
2. *Elaboration and diffusion of performance measures that allow evaluating managerial performance in terms of economy, efficiency, effectiveness and services quality (IFAC, 1991; GASB, 1994).²*
3. *Elaboration of consolidated information including all the services and activities within the local entity's financial accountability scope, regardless of how decentralised its activities are.*

The recent enactment of the 34th Statement, entitled *Basic Financial Statements – and Management's Discussion and Analysis– for State and Local Governments* (GASB, 1999), confirms the importance of the points discussed above in order to enhance public financial statements. This way, the GASB modernises and restructures the information

American state and local governments must present, in an attempt to improve the usefulness of financial statements.

Among the new features introduced by the 34th Statement it is especially important the elaboration of a new financial statement, the *Management's Discussion and Analysis (MD&A)*, which is sought to provide an analytic, objective, and understandable overview of the government's financial activities. With the help of graphics, figures, charts, or any other communicating tools, this document is expected to provide an objective and understandable analysis of the financial activity of the entity, from the perspective of both the short and the long term. The GASB pronouncement (1999; par. 11) regulates the minimum contents this new statement must include (a brief discussion of the basic financial statements, an analysis of the government's overall position and results of operations, an analysis of balances and transactions of funds, etc.).

The MD&A will serve as an introduction to the basic financial statements³, which have incorporated important modifications. The most important of them, from the perspective of information disclosure, is the so-called "statement of activities". This report is devoted to provide information on the net (expense) revenue of each activity, with the purpose of keeping taxpayers informed about the relative financial burden of each of the functions the government performs (GASB, 1999, par. 38). The statement of activities should determine to what extent is such functions financed with the general revenues of the government or self-financing through fees and intergovernmental aid. The difficulty of obtaining and processing the required information parallels its usefulness. This information would provide a much valuable input to the analysis of degree of managerial economy, efficiency, and effectiveness achieved by the entity, contributing in a determinant manner to the assessment of managerial accountability.⁴

Elaboration and Disclosure of Annual Reports

Public accountability requires processing heterogeneous information, from which financial statements occupy a central, but in any case unique, role. In order to assess public accountability and to inform decision making, processing such information to elaborate reports is not enough. Rather, an increasing concern with the communication strategy is coming to the front. These concerns have impelled the development of the so called "annual reports" or "financial reports", which attempt to facilitate the users access to financial information, providing an overview of the government's performance and financial condition. In order to achieve this objective, annual reports contain enormous quantities of economic, social, demographic, and, of course, financial information, concerning not just the government as a service supplier, but also as a geopolitical unit.

In 1994, the OEC published a document containing guidelines for the elaboration of annual reports in France. According to this document:

The annual report is distributed to the municipality's managers and speakers [...]. The objective of the annual report is to summarize the activity of a local government, demonstrate accountability on local finance management and to suggest indications for prospective management. Thus, it should serve for full accountability (OEC, 1994: 34-35).

On the other hand, the IFAC guideline (1998: 199) refers to the general financial reports as those designed to meet the common information needs of users outside the reporting entity. Those external users rely on the reports as an important source of financial information because they have limited authority, ability, or resources to obtain additional information. While financial statements comprise the core of the financial reports, other financial information, such as performance measures or budget information might also be included.

The annual reports elaborated by local governments are documents intended for the general public, with wide diffusion and friendly presentation. They often resemble the annual reports published by large corporations, although the contents are significantly different. It is precisely their content what makes the difference between these documents and other reports elaborated by local governments.

Development of Reports Meeting Specific Needs

Local governments must assist the information demands of different groups of users, which are sometimes interested in some specific financial or operating details. To assist those demands, local governments elaborate the so-called "special reports", oriented to meet the specific needs of certain groups of users (politicians, audit officials, financial institutions, different tiers of government, etc.). It is the user to which they are designed what distinguishes these documents from the annual reports, which are intended for the general public.

The main idea underlying the elaboration of special reports comes from taking into account that different groups of users consider governments and their management accountable for different things. Thus, the same information cannot meet the needs of all the groups (Jones, *et al.*, 1985). Even though accounting standards have shown preference for the elaboration of unique financial statements, governments must elaborate special reports in order to meet specific needs. The local entity may be required to elaborate a special report in order to prove solvency when applying for a new loan, when deciding the final destination of an intergovernmental aid, or even to justify an unexpected turn in the capital investment or tax policy⁵.

The so-called "documents sur la fiscalité locale" elaborated by several French cities – Clamart, Le Havre, Nancy – are a good example of the special reports mentioned above. These reports constitute an attempt to inform taxpayers about the calculation, apportioning, and destiny of the taxes they pay in an understandable fashion. Similarly, in the United Kingdom a "rates leaflet" is distributed to the citizenship containing an overview of the activities scheduled for the year, along with the corresponding budget and an explanation of the contributions required. Last, some local governments – Angoulême (France), Seattle (U.S.) – have looked back to publish reports containing an overview about the temporal evolution of the financial strategy and the financial condition of the entity throughout the last decade.

So far we have focused on surveying current and emerging trends in the evolution of the financial reports elaborated by local entities. The next question to examine is how do local governments disclose the information to the addressees? In other words, which are the communication channels used to keep the users appropriately informed?

COMMUNICATION CHANNELS: THE EMERGING ROLE OF NEW INFORMATION TECHNOLOGIES IN FINANCIAL DISCLOSURE

Nowadays, the most extended communication channel for financial information disclosure in local entities consists in a printed copy of the budget and the annual financial reports deposited in the entity. Even though this copy is kept for public consultation, applicants are frequently not authorised. While most local managers admit that any person that is interested may examine financial statements, various circumstances such as the lack of habit or work overload are behind their unwillingness to grant access. This difficulty to access public information considerably limits research possibilities in this field, especially when trying to gather panel data on a large number of entities. The high costs of data gathering are other important limitations of the current situation in most entities, even when access is granted.

Some solutions adopted in the private corporations may be of interest here. In Spain, the *Central de Balances del Banco de España* (Central Balance Sheet Office) keeps a central database that provides aggregated information of different sectors. Corporations are also obligated to deposit their financial statements in their provincial *Registros Mercantiles* (Commercial Register), which has allowed the development of regional databases in several Autonomous Communities. Some authors have suggested the possibility of creating a Central de Balances for the local public sector; nevertheless, the national and regional *Tribunales de Cuentas* already counts with a similar database, as all the entities must submit their General Accounts. The next step to be done is to disclose that information, granting the access to interested users.

Fortunately, many local governments have begun to care about the final objective of financial statements, adopting a fully communicative attitude. For instance, practices such as depositing financial information in public agencies and libraries (New Zealand) or publication in the media (U.K.) are becoming customary in some countries. The purpose of such practices is to enhance the citizens' access to information about the local government reality. Today, the search for enhanced accessibility makes unavoidable the use of the new information technologies, namely the Internet.

The use of the new information technologies has an enormous impact on the standards of availability and diffusion of information, introducing determinant advantages as readiness, low effort, and low cost in communication. There are a growing number of public entities, not just in the U.S., but around the world in Canada, Australia, New Zealand, the U.K., France or Italy, that provide financial information on the web. Many local governments in those countries include the legally adopted budget, or at least its most important magnitudes in their web pages. Although less frequent, it is also possible to find local entities that include in their web pages the financial statements, the integral and abbreviated versions of the annual report, and other documents containing useful information to assess the financial condition and performance of the entity (long-term strategies, performance indicators, tax rates, statistics on the economic and demographic evolution, etc.).

About 20% of Spanish local entities have a web page. The contents included usually limits to information about the city, its history, its natural environment, cultural activities, maps, and similar tourist details more interesting for the eventual visitor than for regular citizens. The few Spanish city councils that distribute financial information

on the web limit to concise summaries concerning the sources of revenues and the distribution of expenses in the budget. In some cases, web contents also include access to tax by-law and economic and demographic statistics. Thus, the current situation reflects a low exploitation of the possibilities opened by the Internet.

After examining current trends and practices in local financial information disclosure, the next section is devoted to analyze in detail the annual reports. The objective is highlight those features that characterise these reports and differentiate them from other documents, focusing on its typology, structure, content, and presentation.

ANNUAL REPORTS IN LOCAL GOVERNMENTS AROUND THE WORLD

Delimiting and describing the precise content of annual reports is not an easy task, given the great heterogeneity that dominates the elaboration of these documents. However, a high degree of heterogeneity makes comparisons more interesting. Table 1 shows the most interesting features of the reports elaborated by the local governments of the United States, Australia, New Zealand, France, and Spain, as well as some proposals taken from the institutional and academic fields. Even though the analysis was oriented to highlight the common features of the reports elaborated in different countries, clear differences arise even among documents presented in the same country, some of which will be discussed below.

Table 1. Contents and Structure of Annual Reports

Country		EE.UU.	Australia	New Zealand	France		Spain	
Source		several cities	several cities	several cities	several cities	OEC guidebook	City of Barcelona	several cities
Title ^a		CAFR / popular reports	Annual Report	Annual Report	Rapport annuel	Rapport annuel	Informe anual	Anuario económico financiero
Size (pages)		Variable ^b	40-80	90-120	20-40	Variable ^b	> 100	> 100
Institutional contents								
Mayor/executive message		× × ×	× × ×	× × ×	× × ×	× × ×	× × ×	×
Economic and demographic data		× × ×	×	×	× × ×	× × ×	× × ×	×
Organization / structure of the entity		× × ×	× × ×	× × ×	× × ×	× × ×	× × ×	×
Labor relations report (human capital)		×	×	--	×	× × ×	× × ×	× × ×
Achievements	Textual inform. on services/policies	×	× × ×	× × ×	× × ×	× × ×	× × ×	×
	Performance measures	×	× × ×	× × ×	--	× × ×	× × ×	--
	Inform. about costs of services	--	×	× × ×	--	--	--	--
Projects		×	× × ×	-- ^c	--	× × ×	× × ×	--
Financial contents								
Analysis of financial statements	Revenues / taxes	× × ×	×	× × ×	× × ×	× × ×	× × ×	×
	Expenditures	× × ×	×	× × ×	× × ×	× × ×	× × ×	×
	Investment	× × ×	× × ×	× × ×	× × ×	× × ×	× × ×	×
	Debt	× × ×	× × ×	× × ×	× × ×	× × ×	× × ×	×
Financial statements	Entity	× × ×	× × ×	× × ×	× × ×	× × ×	× × ×	× × ×
	Consolidated inf.	× × ×	--	×	× × ×	× × ×	× × ×	× × ×
Appendix		×	× × ×	× × ×	×	× × ×	--	--
Glossary		--	--	×	× × ×	× × ×	--	×

--: None of the reports consulted contained this information.

×: Several reports consulted contained this information.

× × ×: All the reports consulted contained this information.

^a We show the most common title.

^b These entities elaborate two models of annual report: normal (about 200 pages) and abbreviate (about 30 pages).

^c These reports include information about the long-term financial strategy.

In Anglo-Saxon countries, the production of annual reports by local authorities constitutes a broadly extended practice. Given the strong influence of the notion of public accountability in these countries, this task has been induced by tradition rather

than by legal obligation, even though during the last decades notable efforts have been done in the normalisation of the reports.

Governmental units in the U.S. prepare and publish annually a report called CAFR (Comprehensive Annual Financial Report), which is included in the NCGA's Pronouncement #1. This report is divided in three sections: a) the *introductory section* shows general features of the entity, such as its organization chart, the services it provides, and the activities carried; b) the *financial section* includes the auditor's report and the financial statements, along with a set of explanatory notes aimed to provide a better understanding of these statements; and c) the *statistical section* shows socio-economic and demographic data, financial trends, and the composition of taxable base, for various financial years. Sometimes local governments summarize the information gathered in the CAFRs by means of abbreviated financial reports, known as "popular reports". They are less detailed documents, intended for users whose financial information needs can be met with aggregate magnitudes, for instance, average citizens (GASB, 1987; par. 6).

Besides elaborating the annual reports discussed above, some U.S. governments have begun to elaborate and diffuse specific reports on the measurement of the financial condition. It is the case of the State of New York which for several years has elaborated a report aimed to "provide a overview of the State' finances, how tax dollars are spent, and how the economy affects taxpayers" (McCall, 1997). It is a short document that begins showing economic and demographic trends (population, education, rent level), and then examines the financial condition by means of evaluating the main magnitudes of expending by program, debt, and capital investment. Its content is not significantly different than the *Financial Condition Report* elaborated by the City of Seattle. In this case, the measurement and control of the financial condition is done through an analysis of observed trends in a battery of indicators concerning revenues, expenditures, debt levels, and economic and demographic data.

Local entities in other Anglo-Saxon countries as Canada, New Zealand or Australia also elaborate annual reports, although with a less formalised structure and content. We have examined the reports presented by several Australian and New Zealand local entities, noticing some interesting features that worth discussion. First of all, most of these documents include information about the entity's objectives for the financial year, which facilitates comparison with actual results⁶. Likewise, most of these entities – especially those from New Zealand– include information about the net cost of the services, computed as the cost of providing the service less all revenue that can be allocated to those activities. All these documents also include a section devoted to gather environmental information concerning issues such as control of noise levels, water resources management, the accomplishment of health and hygiene normative, and the maintenance of parks and reserves.⁷

In continental Europe, the elaboration of annual reports constitutes a relatively incipient practice impelled by recent legal requirements regarding State and Local Administrations. To provide an idea of how European local entities are assuming the elaboration of annual reports, we have examined the content of the reports prepared by several French and Spanish cities.

In France, the first annual report was published in 1992. Since then, a growing number of local governments have prepared annual reports in that country. A survey carried at the end of 1999, reveals that 26% of the villages with more than 100.000 inhabitants, 34% of the departments and 50% of the regions elaborate this type of documents in France (Angotti and Laurent, 2000: 13). These entities are helped by the guidelines published by the OEC in 1994, which have become the rule when elaborating the annual reports. These guidelines establish a clear difference between two types of reports: *les rapports financiers* include strict financial information, while *les rapports annuels* include a more extensive content, which also includes the financial information.

The scant development of annual reports in the Spanish Local Administration has limited our survey to the report elaborated by the city of Barcelona. This entity publishes a very comprehensive document that provides information about the political and administrative organization of the city council, its economy, the services provided to the citizenship, and managerial details. This report also include a summarized version of the government financial statements, elaborated conforming to the 1994 *Plan de Contabilidad Pública*, as well as its consolidated financial statements. The city councils of several Spanish cities (Madrid, Valencia, Terrassa, Sabadell) elaborate a document called *Anuario Económico Financiero* or *Anuario Estadístico*. Even though these documents are not annual reports, they show the annual evolution of the main economic and demographic variables, including also the individual and consolidated financial statements.

Despite the low interest evidenced by Spanish local entities, the potential usefulness of annual reports has not been unnoticed by the academic literature. The proposal included in Pablos and Fernández (1999)⁸ outlines the elaboration of two types of report, *integral* and *abbreviated*. The purpose of these documents is to keep all the groups of users informed about "the *community's condition*, managerial performance, and the entity's financial condition, also including forecasts and projects for the following years." The rigour and detail of this proposal allows settling down the basis for the improvement of local financial reporting in Spain, even though its diffusion has been very limited.

The discussion above provides an overview of the development of annual reports in these countries' local governments. Absent a set of common rules guiding the elaboration of these documents, the observation of notable differences between countries and even within the same country are not surprising. However, a detailed exam of the content of the annual reports reveal a series of regularities, that provide interesting guidelines for their elaboration:

Typology and Extension

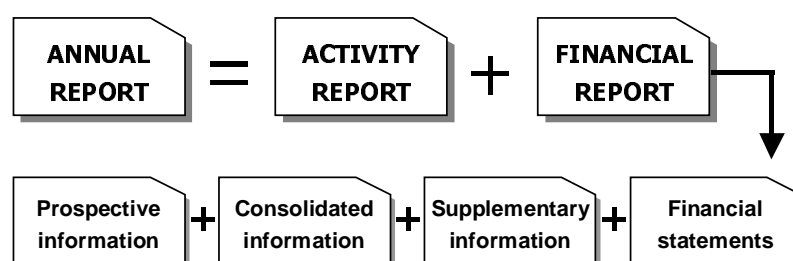
The majority of the local governments examined elaborate two versions of the annual report: a detailed and extended *integral* version and a schematic and *abbreviated* version. The integral version, with an extension beyond 100 pages, does not only meet the information needs of the citizenship, but also inform decision making and the requirements of other groups of users that demand detailed information. The abbreviated version, with an extension between 25 and 30 pages, is intended just for the citizenship, highlighting the results and effects of the policies adopted during the financial year. Any doubt about which are the users of the abbreviated version of the

annual report disappears if we take into account the terms used local governments to refer to this document: popular report, citizen report, report to ratepayers.

Content

The purpose of the annual report is to gather the most relevant information about the municipality's situation and the effects derived from the activity of the local government. It is not limited, thus, to a summary of accounting magnitudes. Rather it includes varied information regarding demographic, socio-economic, and financial features, providing in a reasonable way the "image" of the council. Although there is considerable heterogeneity, the elements integrating the report can be summarized in two big sections: in the first section, the entity informs about the activities undertaken during the year, while the second section, reports the financial magnitudes that allow the assessment of financial management. The guidelines outlined by the OEC in the *Guide d'élaboration du rapport annuel* (OEC, 1994: 36) illustrate this structure:

Figure 1. Structure of the Annual Report (Ordre des Experts Comptables, 1994)



The *activity report* begins with a message of the entity's political or financial responsible, usually the mayor, who writes a brief message summarising and discussing the general trends in the evolution of the entity and its financial condition along the financial year, as well as the initiatives planned for the future. Sometimes this message is accompanied or substituted by a letter written by the entity's financial responsible (manager, financial director, comptroller), in which a more technical description of the report and a brief analysis of its main conclusions is presented.

The degree of complexity that sometimes characterises the structure of the local entity, justifies the inclusion of an organization chart in the report, indicating the divisions, commissions and departments that configure its political-administrative structure. It is also necessary to keep record of all the entities involved in the provision of the services, in order to show the managerial pattern adopted by the entity and, consequently, an overview of the services under its scope.⁹

The report also includes information about the main demographic, economic, and social features concerning the entity. This information is useful not just to describe the entity's environment, but also to assess the effects of public policies on the community. It covers characteristics of the population (age, sex, birth rate), the economic structure (productive structure, gross interior product, personal income, unemployment), and environmental features (pollution levels, weather conditions, natural disasters). In the most complete reports it is possible to find an exhaustive set of indicators devoted to measure quality of life, which allow assessing the outcomes on the level of social welfare of the policies undertaken. These variables summarize the services provided to

the citizen on aspects such as health, education, security, traffic, trade, tourism, and culture.

In some of the entities examined, the information on environmental features and quality of life conforms a separate statement, reflecting the importance attributed to these variables. For instance, the citizens of some Italian cities, as Bologna and Rome, receive a brief report entitled *Lo stato (rapporto) della città*, with plenty of charts and figures describing the demographic and socio-economic features of the city. Similarly, the so called *Perfil de la ciudad de Barcelona* reports a complete battery of indicators "oriented towards providing the citizen with a better knowledge of the current situation of the city, in an attempt to demonstrate public accountability " (Cotrina and Salvat, 1998). This document includes variables such as the salary-years needed to buy a house, the proportion of graduate adults, an index reflecting the interventions of the local police, the traffic intensity, and the number of hospital beds per 1.000 inhabitants.

A common place in local government reporting is the complexity involved in the assessment of policy outcomes. On the opposite hand, the reports include detailed explanations about the actual provision of services, i.e. outputs. In some cases, this information is complemented with a set of performance indicators (especially British municipalities, which, following the *Citizen Charter*, must publish periodic information about performance), and, sometimes, with estimates of the cost associated to each service.

The *financial report* constitutes the section of the annual report that is directly linked to the financial statements. All the reports examined analyze in a more or less detailed manner the content of the financial statements, focusing on features such as the budget implementation level, the volume and composition of the tax revenue, the importance of grants, the magnitude of capital expenditures, the evolution of indebtedness, solvency, and liquidity. Normally, the analysis examines the temporal evolution of a battery of financial indicators, and sometimes these indicators are also compared with the values obtained in similar entities¹⁰. After that analysis, the report shows the financial statements, together with consolidated information (usually limited to budgetary data), and the audit report.

The information contained in the first section of the report, schematically presented, and some of the main financial indicators that summarize the second part, conform the basic content of the abbreviated reports.

Presentation

The purpose of the annual report is not to gather an enormous quantity of information, but rather to communicate that information in a way that the average citizen can understand. Demonstrate accountability by means of the annual report is only feasible if the information offered is, apart from rigorous, must also be clear, understandable, and attractive to the citizenship. This objective justifies the richness of charts, graphics, figures, and pictures that illustrate the textual information included in the report.

The way chosen to present financial data is especially important, because it may condition any posterior analysis. The presentation may follow any of the next two approaches:

1. *Figures and charts showing trends for the entity's main financial and economic magnitudes in a sufficiently large period. The financial trend profile, proposed by the ICMA (Groves, Godsey and Shulman, 1981), illustrates this approach. It graphically represents the values of a battery of financial indicators throughout a five years period, revealing the historical profile of the entity's financial condition.*
2. *Rankings comparing entities with similar characteristic. Despite the complexity involved in the elaboration of these rankings, there is a vast literature that has embraced this approach. Petro (1998) suggests presenting the average value of each financial indicator for each class of entities – determined on the basis of geographic location and population– in the so called benchmark reports, indicating the entity's relative position when compared with the entities included in its class.*

CONCLUDING REMARKS

The usefulness of the financial information elaborated by the local entities depends to a large extent on its availability. Even if accounting statements are correctly elaborated, their utility would be scant if access to potential users is not granted. Appropriate diffusion of the financial information allows the government to keep publicly accountable, and can be interpreted as a bonding cost incurred to create an image of transparency, a reputation, that helps justifying past decisions and basing policies for the future.

Rather than just limit elaborate financial reports, local governments should be able to grant effective access to the citizenship. It is true that, adopting a strict accountability view, accounting systems are beneficial even in the case that none of the two parties involved does ever consult the reports generated. But there is no question that such benefits are enormously increased when the system creates the conditions for an effective exchange of information between the two parties. For this reason, there is a growing interest today on “financial disclosure,” which parallels the emphasis of private organizations on internal and external communication throughout the last two decades.

The most recent experiences show that most financial reports are designed for the *general public*, thus contributing to the objective of accountability. The focus on these users finds support in a growing body of literature that stresses the need to devote financial reports to those who have a more difficult access to information, even though they hold legitimate economic, political, and social interest on it. Nevertheless, given the exhaustive and rigorous content of these reports, they also can be useful for some of the stakeholders included in the professionals group.

The increasing concern with the communication of financial information to the citizenship –including the reporting, the explanation, and the diffusion of that information – has impelled the development of the “annual report” or “financial report”, that attempts to facilitate access to the users of financial information. The report also must provide an overview of government performance and financial condition. To achieve these objective, annual reports contain enormous quantities of economic, social,

demographic, and, of course, financial information, concerning not just the government as a services supplier, but also as a geopolitical unit. Based on the documents analyzed in this article, we derive the following conclusions about the annual report:

- It must contain enough information to assess the outcomes resulting from the activities of those involved in local community development and, in particular, from the public policies undertaken. We should not forget that local public policies (and, consequently, the proposals included in the electoral programs) are oriented to increase the “welfare of the local community,” and, thus, appropriate indicators must be used to demonstrate accountability for welfare effects to the citizenship.
- It must contribute to demonstrate accountability about entity management, showing the results obtained and the objectives pursued. This task requires enumerating the objectives, the resources available, the net expenditures incurred, and the outcomes attained, including indicators showing entity level of efficiency and effectiveness.
- It must contribute to accounting for the financial management of the previous period. The report contains the annual financial statements foreseen by the local regulations, accompanied by the audit report. These documents provide the basis to analyze and interpret entity financial, budgetary, and fiduciary situation.
- It must elaborate and emphasise the communication of entity financial health in an appealing format that can be easily understood by the general public.

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Notes

¹ Ley Reguladora de las Haciendas Locales (LRHL), Instrucción de Contabilidad para la Administración Local (ICAL), and Real Decreto 500/1990.

² Nowadays, there exist several local governments that include information on costs and managerial results in their annual financial statements. For a survey of performance indicators in different countries see Poister (1999) and Guarini (2000).

³ According to the Statement nº 34, the minimum requirements for general purpose external financial reports of state and local governments are MD&A, basic financial statements (including government-wide financial statements, fund financial statements and notes to the financial statements), and required supplementary information.

⁴ This one is not the first initiative concerning the elaboration of this type of documents. The Statement of Cost of Service presented by local entities in New Zealand, the Statement of Net Costs elaborated by the federal government in the U.S., and the *Rapport sur le Rendement* in Canada, provide some examples of documents devoted to report information about the costs of public services.

⁵ According to the GASB (1987, par. 7), special purpose financial reports are generally used to a) meet specific legal or contractual requirements, b) present financial statements using a basis of accounting that differs from generally accepted accounting principles, c) present financial information in prescribed formats, or d) report on specified elements, accounts, or items taken from the general purpose financial statements.

⁶ In Australian local governments, the very standards recommend that "the general purpose financial reports should form part of a overall report of the governing body. That report may usefully include commentary on the policies, objectives and achievements of the governing body" (AARF, 1993; par. 85). The annual report elaborated by the city of Sydney graphically shows this type of information by means of a scheme that reports the objectives and goals pursued, and the results actually obtained within each key performance area during the year.

⁷ That phenomenon responds to the strong doctrinal current that, for already some years, it postulates the use of the accounting reports as vehicle to demonstrate the environmental accountability of an organization (Maunders and Burritt, 1991; Burritt and Welch, 1997, among other). The objective outlined by the integral authors of this current consists on achieving that the so much entities of the public sector like of the private one they use its annual reports to communicate the outcomes of its activity on the environment.

⁸ This work is the result of a study financed by the *Instituto de Estudios Fiscales* and carried by the following research group: José Luis Pablos and José Miguel Fernández (Coordinators), Isabel Brusca, M^a Belén Morala, Pilar Arbesú, and Ana Cárcaba.

⁹ The annual reports elaborated by several French cities include this information in the so-called "périmètre d'intervention et participations", which is accompanied by an explanatory chart showing the links between the government and entities for which it is responsible.

¹⁰ According to the GASB (1999), this part of the annual report configures the essential content of the MD&A.

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